February 11, 1938

Mr. Charles R. Gay,
President, New York Stock Exchange,
New York, New York.

Dear Mr. Gay:

It will be recalled that the Commission, on February 18, 1937, referred to the Committee on Business Conduct of the New York State Exchange the matter of trading by one of its members, Reginald V. Biscoe, in Louisiana Oil Refining Corporation convertible preferred stock during the period from May 9 to June 8, 1936. Mr. Lindley, Chairman of the Committee on Business Conduct, in his letter of April 12, 1937, reported to Mr. Seperstein the disposition of the matter by the Exchange.

In his reply Mr. Lindley indicated that the Committee on Business Conduct considered the possible application of Sections 17 and 20 of Chapter XIV of the Rules of the Governing Committee to Mr. Hiscoe's transactions. Section 17 provides:

"Sec. 17. No member and no firm of which he is a partner and no partner of such firm shall effect on the Exchange purchases or sales for any account in which such member, firm or partner is directly or indirectly interested, which purchases or sales are excessive in view of the financial resources of such member, firm or partner or in view of the market for such security."

Section 20 provides:

"Sec. 20. No member, and no firm of which he is a partner and no partner of such firm shall execute or cause to be executed on the Exchange the purchase of any security at successfully higher prices or the sale of any security at successively lower prices for the purpose of creating or inducing a false, misleading or artificial appearance of activity in such security, or for the purpose of unduly or improperly influencing the market price of such security, or for the purpose of making a price which does not reflect the true state of the market in such security."

Mr. Lindley indicated that the Committee on Business Conduct had concluded that Mr. Hiscoe's trading violated neither rule. In his letter of April 12, 1937, Mr. Lindley stated (page 6) that the Committee on Business Conduct and Odd Lots and Specialists were satisfied that Mr. Hiscoe "was trying to accumulate a long position is the stock for investment purposes.” I understand likewise that shortly after the receipt of your letter, in the course of a visit to the New York Regional Office, Mr. Robert Stott, a member of the Business Conduct Committee and of the Committee on Odd Lots and Specialists, expressed the view that so long as Mr. Hiscoe believed that the stock at all times was worth the prices he paid for it, and so long as Mr. Hiscoe was consistently on either the buying or selling side and did not trade “in and out”, buying and then reselling or vice versa, his transactions could not be regarded as in violation of Section 17.

In connection with the formulation by the Commission its future policy of regulation, I have had the entire case presented at great length before the full Commission. As a result of the Commission’s reconsideration of the matter, I am writing to set forth the following aspects of the matter.

The 35,290 shares of Louisiana Oil Refining Corporation convertible preferred stock outstanding were traded on the New York Stock Exchange pursuant to an exemption afforded by the then Rule AMS(b)(2) of the Commission, which exemption nevertheless left the stock subject to Section 9(a) of the Securities Exchange Act. The company was in reorganization pursuant to Section 77B. The stock, being on the incentive list of the Exchange, was traded in units of 10 shares. The transactions for the months of March and April 1936 totaled approximately 1,000 shares in each month.

From May 7 to May 12, 1935, the total volume of transactions was 8,000[illegible] shares, the price ranging from 19-1/4 on May 7 to 34-1/2 on May 11 (closing May 12 at 30-1/4). Mr. Hisoce purchased on every trading day during this period, his purchases totaling 8,000 shares or 22.5% of the total volume, at prices from 19-5/8 to 34.

From May 13 to May 19, inclusive, Mr. Hiscoe made no purchases. During this time the total volume was 1,980 shares, the price ranging between 31 and 27, closing at 27-1/4 on May 19.

During the period from May 20 to May 25, inclusive, further purchases were made, 500 shares for the account of Mr. Hisoce and 200 for the account of Mrs. Hiscoe, at prices from 29-3/4 on May 20 to 47-1/2 on May 25. These purchases were 13% of the total volume of 5,250 shares, the price of the stock ranging from 27-1/8 on May 20 to 31-1/3 May 25, the stock closing at 48-1/2 on May 25.

During the entire period from May 7 to May 25 these purchases totaled 2,700 shares, or 7.5% of the outstanding stock. On individual days in the course of his reaching for stock, Mr. Hiscoe’s purchases were as high as 29% of the daily volume.

For example, on May 8, 1936 Mr. Hiscoe bought 750 of the 2,850 shares traded. On that morning after a total of 260 shares had been transacted at 20-1/4, 20-3/8 and 20-1/2 up to 10:11 A.M., Mr. Hiscoe gave an order to buy 250 shares at the market, whereupon the next transactions, executed between 10:15 and 10:16 were as follows:

20 @ 21
50 @ 21
50 @ 21-1/2
30 @ 21-1/2
130 @ 21-3/4

All of these (except 30 of the 50 shares at 31-1/2) were bought by Mr. Hiscoe on his order indicated above. Later that day, after having purchased an additional 100 shares at 22-3/4, Mr. Hiscoe gave orders as follows:

12:28 P.M. Buy 100 at market
12:37 P.M. Buy 100 at market
12:42 P.M. Buy 200 at market
12:45 P.M. Buy 200 at 25, cancel market
12:45 P.M. Buy 80 at market, cancel 25

As a result, in the twenty-minute period between 12:30 P.M. and 12:50 P.M., Mr. Hiscoe bought 400 of the 650 shares traded, at prices from 23 to 25-3/4. In a few minutes the stock sold at 26, the high of the day, up 5-3/4 from the previous day's close, thereafter selling down to 24-1/2 and closing at 24-3/4. In the course of so reaching for stock on this and other days, Mr. Hiscoe's own purchases made many new highs, apart from affecting the price at which other transactions took place as a result of the objective situation created by his orders.

From May 26 to June 5, inclusive, 2,550 of the 2,500 shares purchased for the account of Mr. Hiscoe and the 100 for the account of Mrs. Hiscoe were liquidated. Rules were made on every day during the period at prices from 49-1/2 on May 26 to 31 on June 4. These sales were 33% of the total volume during the period (and were as high 42% of the volume on individual days). The stock ranged from 49-1/8 on May 26 down to 51 on June 4 and June 5, the stock closing at 36-1/2 on June 3.

On June 5 Mr. Hiscoe sold 140 shares at prices from 31-5/8 to 34-1/2. His last sale was of 20 shares at 34-1/2 at 11:22 A.M. Between that time and 2:00 P.M. there were two transactions, each for 10 shares, at 34 and 34-1/2. At 2:00 P.M. Mr. Hiscoe gave the first of three orders to buy, each for 350 shares, at limits successively fixed at 35, 35-1/2 and 36, these limits being above the prices of the last reported transactions. From 2:00 to 2:30 P.M. when the volume was 330 shares, Mr. Hiscoe as these orders bought a total of 290 shares at process from 34-1/2 up to 36. Thereafter to the close the volume was 110 shares, at prices from 36 to 36-1/2, the latter being the closing price that day. Of transactions totaling 950 shares that day, Mr. Hiscoe thus sold 140 shares and bought 290 shares.

The next day, June 6, in the first eight minutes of trading, Mr. Hiscoe purchased 60 shares at prices from 37-1/4 to 39, the high for the day, the price thereafter declining to 35-1/4, the close. The total volume that day was 190 shares. The next trading day, June 8, Mr. Hiscoe sold 300 shares at process ranging between 35 and 36-1/2, the volume being 340 shares.

Apart from the application of any other rules or rules, the Commission cannot with the conclusion of the New York Stock Exchange that Mr. Hiscoe's trading was not excessive in view of the market in this stock, and that consequently he did not violate Section 17. The Commission feels that the undisputed facts set forth in Mr. Holohan's report, in the Exchange's allotment sheets and in the record before the Business Conduct Committee demonstrate that Mr. Hiscoe's trading viewed as a whole and the particular transactions during the period in question were excessive within the meaning of Section 17 of the Rules.

As we read the rule, Section 17 nowhere makes the considerations mentioned by Mr. Lindley and Mr. Stott relevant to the existence of a violation. The test, as set forth in that rule, is whether the "purchases or sales" are excessive, not with reference to any standard of value, or to motive or purpose, but "in view of the market for such security." Clearly, it is possible to violate the rule though the member may at all times believe the stock is worth more than the prices at which he purchases and that the stock will in the future sell above such prices. It would seem that Louisiana Oil Refining Corporation Preferred Stock afforded a particularly apt illustration of this possibility, in view of the company's status at that time, the small amount of outstanding stock, and its classification as an incentive stock traded in ten-share units.

In view of this decision of the Committee on Business Conduct, the Commission has directed and authorized me to lay the matter before you for the purpose of clarification of policy. Is this decision to be considered as a precedent in interpreting Section 17 of Chapter XIV of the Rules of the Governing Committee?

Yours faithfully,

William O. Douglas,
Chairman.